Promoting Financial Inclusion in India

Evidence from Au FINANCIERS (INDIA) LIMITED[1]

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Acronyms

CV	Commercial Vehicle
CRR	Cash Reserve Ratio
CAGR	Compound Annual Growth Rate
CGEDI	Development Impact Department
GDP	Gross Domestic Product
FIs	Financial Institutions
FY	Financial year
INR	Indian Rupees
LIS	Low Income States
LAP	Loans Against Property
MSME	Micro, Small and Medium Enterprises
NBFCs	Non Banking Financial Companies
NCDs	Non-convertible debentures
NPL	Non performing loan
PE	Private Equity
RBI	Reserve Bank of India
SME	Small and Medium Enterprises

Executive Summary

By 2020 an additional 600 million new jobs will be needed as a result of global population growth. The private sector currently provides nine out of ten jobs in developing countries, and so will be critical to meeting this challenge. IFC, a member of the World Bank Group, aims to help people escape poverty and boost shared prosperity by promoting private sector-led growth. As part of these goals, IFC provides both investment and advisory services to financial institutions (FIs) in India, to expand access to finance for local micro, small and medium enterprises (MSMEs), support the growth of their businesses, create new jobs, and, through this, contribute to the country's economic growth. In 2012, the MSME sector in India consisted of approximately 29.8 million participants, which contributed 11.5% of gross domestic product (GDP), over 45% of India's industrial output, 40% of exports and employed 69 million people.

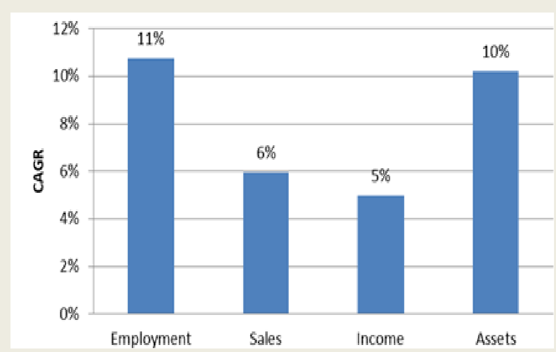
As a part of its investment activities in India's low income states (LIS), IFC has supported Au FINANCIERS (INDIA) LIMITED (referred to as "Au FINANCIERS" or "Au" in this study) since 2010 in the expansion of its transport finance to small road transport operators (herein referred to primarily as commercial vehicle (CV) business) and in offering new services such as MSME finance and housing finance in LIS. Au started its operations in Rajasthan (one of the poorest states in India) and over the last decade, has expanded to other under-served markets in Madhya Pradesh, Gujarat, Maharashtra, Delhi and Punjab. Au has expanded its loan portfolio to INR 46.36 billion and increased the number of MSME borrowers to 183,867, while maintaining healthy portfolio quality (at 1.3%) and achieving a reduction in loan processing time. The primary objective of this study is to assess Au's contribution towards financial inclusion, job creation, and the financial performance of beneficiary firms in India over financial years 2012-2014 (FY12-14)[2]. In particular, this study examines the SME and CV borrowers, explores how financing is being utilized, how many jobs are being created or supported, how real income is changing, and how many borrowers were included in the formal financial system by Au.

This study was conducted in December 2014. It triangulates data from secondary sources along with primary data from loan file reviews and field interviews with Au's employees, MSME and CV beneficiaries, using simple statistical techniques, including regressions.

Despite challenging macro-economic downturns in 2011-12, clients with MSME and CV loans show positive effects on jobs, assets, income and sales being supported. The MSME[3] analysis shows the following:

- ***Employment in the sample grew at a compound annual growth rate (CAGR) of 11%[4].***
- ***Sales for the MSME beneficiaries in the sample grew by an CAGR of 6%[4].***
- ***MSME beneficiaries in the sample saw an increase in their incomes during the study period at a CAGR of 5%[4].***
- ***Beneficiaries were able to accumulate additional productive assets, such as commercial property, vehicles and equipment/machinery. The growth in asset value for MSMEs sampled was an impressive 10% CAGR[4]. Retail and Services enterprises in the sample consistently performed the best across different measures, while loans taken for the purpose of working capital performed the best across the different measures observed.***
- ***Au FINANCIERS is able to successfully reach unserved and underserved populations, such as first time borrowers and borrowers in LIS. First time borrowers performed well on all measured growth metrics, including employment, sales, income and assets.***
- ***Regression analysis shows that jobs and sales are positively associated with increased access to financial services. An INR 690,000 loan in FY12 is associated with 1 additional job[5].***

Figure 1: Average growth in key variables



Source: Au Loan Files, Loan Officer Review and Authors' Computation

The CV analysis shows the following:

- ***20 customers with multiple CV loans grew their annual real income by 39% CAGR[4].***

2 The fiscal year in India runs from April to March.
3 The MSME analysis is based on review of MSME loans between INR 500,000 to INR 2.5 million.
4 After adjusting for inflation.
5 This result differs marginally from the extrapolation result (INR 460,000 loan is expected to result in 1 additional job) as the regression coefficient is a more conservative estimate and is significant at 90% level of significance.

- ***25% of the clients' sampled shifted into home ownership during the period studied.***
- ***Sampled clients grew their vehicle fleet by 141% CAGR[4] between taking a loan from Au in FY12 and the most recent loan taken by them.***
- ***Through their financing of the sampled CV portfolio, Au indirectly supported at least 125 jobs , of which 63 new jobs were created over the period FY12-FY15.***

Interviews with Au beneficiaries have confirmed the impact that working with Au FINANCIERS has had on their lives. Beneficiaries have seen substantial increases in income and assets. They have been able to increase employment in their growing businesses, as well as invest disposable income into the education of their children. In addition, many borrowers who were previously financially excluded (and may have paid usurious rates to money lenders) opened bank accounts, and are now able to obtain financing from other FIs due to the documentation and credit history they have developed by borrowing from Au FINANCIERS.

These results validate the thinking that MSMEs are vital to support economic growth and create new jobs in developing economies like India. This should encourage other FIs to continue supporting MSMEs through financing and other services. The results also validate the important role that Au FINANCIERS has and will continue to play in India's LIS, increasing financial inclusion, and supporting job creation, increased incomes and better livelihoods.

Introduction

Globally, MSMEs play a key role in creating jobs. This is especially true in developing economies where the World Bank Group's Enterprise Surveys find that small firms account for the highest share of employment. They also promote economic growth and contribute to the development of the private sector. At the same time, access to finance is critical in helping develop the MSME sector in any country. An analysis using the World Bank Group's Enterprise Surveys data found a positive relationship between financial development and entrepreneurship, suggesting that improved access to finance is associated with a vibrant private sector[6].

FIs play a fundamental role in supporting private sector development through financial services. Financial systems help mobilize and pool savings, provide payments services that facilitate the exchange of goods and services, produce and process information about investors and investment projects to enable efficient allocation of funds, monitor investments and exert corporate governance after these funds are allocated, and help diversify, transform and manage risk[7].

It is reasonable to expect that IFC through its investments and advisory services to FIs and by promoting responsible finance in developing countries is supporting job creation and economic growth. For example, when IFC invests in client FIs, these FIs can expand wider range of products or services. Firms obtain

MSME Hotel Construction Loan

The borrower, Mr. Sharma, obtained a loan from Au to finance the construction of a small hotel in Jaipur, in the area near the train station. Before building the hotel, Mr. Sharma had a food trolley in the train station. With the money he saved from this work, he was able to build the first floor of the hotel, however it was not successful due to its small size. He therefore reached out to various lenders to get financing to build more floors for the hotel. After being rejected by all other lenders, he was able to obtain the financing in 2011 from Au, for a total amount of INR 1.5 million. He had never received any other loan previously, and had used the hotel property as the collateral for the loan.

With the loan, Mr. Sharma built two additional floors with 27 rooms in total. The hotel he runs now employs 10 people, including him and his family members. Previously, he had earned a monthly income of around INR 30,000 a month from his food trolley business. He has retained that business, but now also makes INR 100,000 a month on average from the hotel. Mr. Sharma mentioned that he may apply for an additional loan from Au to further expand his hotel in the near future.

6 Klapper, L. Amit, R. Guillén, MF. and Quesada, JM. 2007. Entrepreneurship and firm formation across countries. The World Bank, Research Paper 4313.
7 Demirguc-Kunt, A. 2006. Finance And Economic Development: Policy Choices For Developing Countries The World Bank, Policy Research Working Papers.

loans from FIs to start operations, to finance working capital needs, or to expand operations (by increasing capacity or entering new business lines). These firms, if profitable and operating in a supportive political and economic environment should be able to grow their businesses and create jobs in the economy.

In 2012-13, IFC's Development Impact Department (CGEDI) conducted a series of case studies called "Assessing Private Sector Contributions to Job Creation and Poverty Reduction"[8], which develop estimates for indirect job creation effects across industries and countries. As a part of this global study, CGEDI conducted five case studies which focused on job creation by MSMEs supported through a partner FI.

This study replicates and improves the methodology used for the IFC Jobs Study, to add to the initial body of evidence on job creation effects of expanding access to finance to MSMEs. It focuses on Au FINANCIERS, one of IFC's partner non-banking financial companies (NBFCs), to study the development effects of the FI's MSME finance activities in LIS of India. The findings of this study support the belief that Au FINANCIERS' work has resulted and is expected to further improve access to finance for the underserved segments through enabling access to credit and other financial products.

Country Context

The MSME sector has been widely acknowledged to be of substantial importance to the Indian economy. The sector feeds crucial industrial value chains and provides broad-based employment to the country's working age population including its semi-skilled and unskilled workers. As per an IFC – Government of Japan study on MSME financing in India, the MSME sector in 2012 consisted of approximately 29.8 million participants which contributed 11.5% of gross domestic product (GDP), over 45% of India's industrial output and 40% of exports and employs 69 million people[9]. 33% of these MSMEs are in LIS[10] which have low access to financial and infrastructure services. Other studies have suggested it is the largest source of employment in the country other than agriculture. Despite its importance to the socio-economic development of the country, the sector's growth is constrained by poor infrastructure and inadequate market linkages.

On the demand side, lack of adequate and timely access to finance has been amongst the biggest challenges to the sector. FIs have limited their exposure to the sector due to a higher risk perception and limited access of MSMEs to immovable collateral. As per the IFC study cited above, the total debt financing gap for the MSME sector is estimated at INR 19 trillion, out of which close to INR 2.9 trillion is projected to be viable and addressable under the current policy framework. The MSME segment accounts for INR 2.93 trillion of the debt gap that is viable and can be addressed by FIs in the near term. 66% of this debt gap is in LIS (e.g. Rajasthan). This debt gap is currently being partly addressed by informal sources such as money lenders.

Lack of access to financial services, coupled with complex and time consuming registration procedures has resulted in approximately 94% of MSMEs being informal[11]. As these enterprises are not registered and many of them do not pay income tax, it makes it all the more difficult for them to raise money directly for their business. A lack of documentation forces them to take personal loans, which may be used to support their businesses.

On the supply side, banks are reluctant to lend to MSMEs due to information asymmetry - informal unregistered firms have poor documents supporting their business, and suffer from a lack of appropriate accounting practices with multiple balance sheets. As national banks may not always have local knowledge about the financial viability of these MSMEs, they are reluctant to lend to MSMEs. However, local NBFCs have this local knowledge and are better able to manage loan performance while keeping the number of non-performing loans (NPLs) low.

These demand and supply side constraints are even more challenging in LIS (e.g. Rajasthan). In 2012, LIS housed 45% of India population but 60% of India's poor[11]. These states are characterized by lower per capita GDP, and access to services is below country average. As a result, a higher proportion of firms are informal and unregistered with little or no documents. FIs are reluctant to on-lend to firms with little or no credit history in LIS, because of low upside and high risk.

Over the last decade NBFCs in India have undergone a consolidation process, with many of them merging or closing down. According to the Ministry of Finance, the number of NBFCs decreased from 13,014 in 2006 to 12,409 in 2011, while the NBFC industry grew by 2.6

8 IFC. 2013. Jobs Study.
9 IFC. 2012. Improving Access to Finance for Women-owned Business in India.
10 IFC. 2012. Micro, Small, and Medium Enterprise Finance in India, A Research Study on Needs, Gaps and Way Forward.
11 Central Statistical Organization

times over the same period at a CAGR of 21%[12]. The MSME loan market for NBFCs in India is growing at a CAGR of 23.3%[13]. It is estimated that MSMEs in India have a total finance demand of INR 32.5 trillion, of which the addressable market for FIs is INR 11.8 trillion[14]. Given that INR 7.0 trillion is currently provided by FIs, the supply–demand gap of close to INR 4.8 trillion has broadened the potential markets for NBFCs in India, on which they need to capitalize[15].

NBFCs are aggressively focusing on loans to the MSME sector. Though the cost of funding through NBFCs is generally 1.0%–1.5% higher than bank lending rates, the terms of funding - such as security and collateral requirements and structured repayment terms - are more benign than those of banks. Furthermore, NBFCs have focused on a new segment of clients who are not yet served by banks, i.e., financing MSMEs through innovative products and services such as loans against property and financing for secondhand and reconditioned vehicles, construction equipment, and secured and unsecured working capital. One such business model is to offer multiple products to the clients - MSME loans, CV loans, personal loans and insurance. The insights from CV financing are utilized in facilitating additional credit decisions including provision of larger loans.

The CV Financing Industry in India has seen an impressive growth. In the last five years up until 2012-13, CV loan disbursements grew by about 11%[16]. NBFCs play an important role in CV financing because their regulatory requirements are less stringent as compared to banks. They are able to customize their products and are not bound by priority sector lending or cash reserve ratio (CRR) norms. Over the last decade, the vehicle finance industry in India has fragmented, with banks focusing on car loans while NBFCs focus on CV loans.

This industry is expected to continue to grow at a CAGR of 15% over the period 2011-12 to 2016-17[17]. Improvements in road infrastructure in rural and semi-urban areas will be one of the main drivers of this growth. In addition, the growth of the CV industry has been linked to the country's industrial activities and the overall GDP.

Au and its relationship with IFC

Au FINANCIERS (INDIA) LIMITED (referred to as "Au FINANCIERS or "Au" in this study) is a registered, non-deposit taking, systematically important NBFC headquartered in the low income state of Rajasthan. Au targets rural and semi-urban markets in India (e.g., Maharashtra, Gujarat, Madhya Pradesh, Punjab, Goa, and Chhattisgarh). Au is engaged primarily in transport finance loans (new and used) with a developing business of loans against property (LAP) for MSME financing, housing finance loans and insurance broking under its new subsidiaries. Au provides loans to low-income, self-employed, first-time and small transport entrepreneurs, while LAP loans are to support income generating activities of micro and small manufacturers and service enterprises, and agriculture based MSMEs. Over 95% of the loans provided by Au are classified as priority sector lending under the Reserve Bank of India (RBI) guidelines. It has been rated "A Stable" by CRISIL. As of October 2014, Au has a presence in 10 states through 223 branches, the majority of which are in Rajasthan (104 branches), Maharashtra (40 branches) and Gujarat (40 branches). It has reached approximately 254,000 CV customers through its branches since 2003.

Au was incorporated in 1996 by a first-generation entrepreneur. In its initial phase, it raised funding from high net worth individuals to provide vehicle loans within Rajasthan. In 1999 it adopted a fee based model, working as an originator for private banks. In 2006 it expanded operations to Maharashtra and in 2008 it expanded further into Gujarat. It also received a first round of private equity (PE) funding and began to directly fund its assets. In 2010 Au attained NBFC status, and began its MSME business. In 2011 Au established Au Housing Finance, and expanded into Punjab, Madhya Pradesh and Goa. In 2012 the company started Au Insurance, a licensed insurance broking company, and diversified its liability mix to multiple sources and instruments. It also expanded to Chhattisgarh. In 2013-14 Au expanded into Delhi, Haryana and Himachal Pradesh, and received its fourth round of equity.

Au's competitive advantages include its quick turnaround time, its broad coverage in largely untapped semi-urban and rural markets, strong asset quality portfolio, local manpower with high employee

12 Department of Financial Services, Ministry of Finance. Key Advisory Group Report on Non Banking Finance Companies in India 31 July 2012.
13 Kothari, S. 2013. Analysis of MSME Small Loan Credit Market for NBFCs in India.
14 The un-addressable demand comprises demand from (a) sick enterprises, (b) new enterprises (those with less than a year in operation), (c) enterprises rejected by financial institutions (d) micro enterprises that prefer finance from the informal sector.
15 ADB 2013 SME Monitor in Asia.
16 CRISIL Research 2013, Retail Finance- Auto.
17 http://www.ey.com/IN/en/Newsroom/News-releases/Press-Release_Indian-Commercial-Vehicle-sales-to-hit

retention, a diversified resource mix, and high quality priority sector assets.

As of September 2014, Au's loan portfolio was INR 46.46 billion outstanding, for 183,867 clients. Transport finance loans comprise 67% of the portfolio, including heavy CVs, light CVs, small and multi-utility CVs, three wheelers and cars. The average outstanding loan size for this portfolio ranges from approximately INR 119,000 for three wheelers to INR 721,000 for heavy CVs, with an average outstanding loan size of INR 301,000. MSMEs comprise 22% of the portfolio; this includes loans against property for a business purpose provided to manufacturers, retailers, schools, service providers and others. The average outstanding loan size in the MSME category is around INR 619,000, while the maximum loan size is INR 2.5 million. As of September 2014, 56% of Au's assets under management were in Rajasthan, 17% in Maharashtra, and 14% in Gujarat.

Au's housing finance subsidiary company provides home loans for renovation, home improvement and new houses. It also provides affordable housing finance (low cost housing to low income groups in semi-urban /rural areas) and rural housing finance. The average ticket size across this product suite is INR 690,000 and total outstanding is INR 5.3 billion.

In March 2010, IFC had supported Au (then with an asset base of INR 4.9 billion), through an equity investment of US$7.8 million. In Feb 2012, IFC made an additional investment of US$6.6 million (equity) along with Warburg Pincus, bringing IFC's total investment in Au to US$14.4million, for an 18.3% stake. Since IFC's first investment in Au in FY10-11, Au has grown its branch network by 3 times, assets under management by 8 times, its customer base by 6 times and net worth by almost 7 times. In April 2014 IFC also made an additional investment of INR 285 million in the new round of rights/preference issued by the Company, raising its stake from 18.05% to 18.71% due to partial dilution by the promoter. In June 2014 IFC subscribed to Au's listed, secured, non-convertible debentures (NCDs) worth INR 1.45 billion. This was IFC's first local currency debt to FIs in India.

IFC has been providing advisory and investment assistance to Au on improving its corporate governance standards, asset liability and risk management systems, and scoping MSME and affordable housing finance market potential for product diversification. Further, IFC has assisted Au in diversifying funding sources, now with over 50 major banks in India, including the Small Industries Development Bank of India, hiring and retaining senior resources, attracting new investors of high pedigree (Warburg Pincus and Chrys Capital), and improving its credit rating.

Methodology

This study was based on data reviewed for 128 active clients from Au's MSME and CV portfolios. A sample of 108 active MSME clients that received a loan of INR 500,000 (or above)[18] but below INR 2.5 million[19] in FY12 was randomly selected. A INR 500,000 threshold was used to identify and focus on the small and medium enterprise portion of Au's MSME portfolio; going forward we will be referring to these as MSME loans. The number of clients selected (108) represents a small enough sample to meet practical constraints whilst being large enough to enable meaningful inference about the population from which this sample was drawn. In addition, it is representative of the sectoral distribution and covered 13% of the total population[20]. It is also important to highlight that this is the first study of this kind, conducted by IFC that includes non-performing loans. In addition, a small random sample of 20 active clients with multiple CV loans and at least one CV loan approved in FY 2012 were included in the study. The CV analysis is not representative but provides interesting qualitative findings. The MSME results and CV results are presented in two different sections of this report.

In December 2014, a joint IFC team comprising of the Financial Institutions Group Strategy and Development Impact Departments visited Au FINANCIERS in Jaipur to conduct a Development Impact study. The team was supported by the South Asia Financial Institutions Group's portfolio team and the Au Team.

During the visit, the team reviewed 108 MSME client loan files and 20 CV client loan files to understand the characteristics of the clients at the time of the loan origination. The team also conducted a qualitative analysis of the clients by visiting the premises of some of the clients sampled and discussing with them the evolution of their businesses and impact. In addition, Au's team provided complementary data from its MIS system and contacted the sampled MSMEs to collect

18 SMEs in India are defined by asset size or total investment in machinery and equipment. The usual perception is that enterprises who take loans of INR 500,000 would have total investment of at least INR 1 million which is local SME definition. As the sample includes enterprises which took loans greater than INR 500,000, we can conclude that the sample does not include any micro-enterprises. Hence the sample and associated extrapolation would be applicable to SMEs.

19 Au refers to loans greater than INR 2.5 million as SME loans. However, these are usually considered as corporate loans in the local context.

20 857 MSME clients that received a loan of INR 500,000 but below INR 2.5 million in FY12.

updated information about their current characteristics (two years after obtaining the MSME loan from Au) achieving a response rate of more than 80%.

The reviews and data collection conducted by the Au and IFC team aimed to obtain firm-level information on financial inclusion, job creation[21] and financial performance between 2012 and 2014. The period of two years was chosen to measure the employment effects for firms having capital to start and expand operations, while limiting other external factors on job growth that could occur over a longer period. Of the 108 MSME clients reviewed, Au's team was able to collect 2012 and 2014 information for the key variables (employment, assets, sales and income) for about 90 clients (with slight differences for each variable). Nominal changes in these key variables were converted to real changes with 2012 as base year[22].

Caveats

Given the data limitations in the loan files and nature of field-based interviews, there are inherent caveats which must be kept in mind while interpreting the results. These include:

(i) Attribution: The study measures changes in key variables for the sampled MSMEs and extrapolates to the MSME portfolio of Au (loans from INR 500,000 to INR 2.5 million) in FY12. However, given that it is difficult to control for these firms obtaining loans from other FIs, and to isolate macroeconomic and business conditions in the country, the total effects on key variables cannot be attributed solely to the loans obtained or to IFC's engagement with Au FINANCIERS.

(ii) Omitted Variable Bias: Changes in key variables may be influenced by other indicators which were not analyzed in this study. For example, macro-economic condition, age and experience of business owners are likely causal determinants of key variables (e.g. loan size, job and asset growth). The omission of such variables results in omitted variable bias and limits statistical inference particularly for regressions which try to measure causal effects.

(iii) Generalization and Prediction: The results of this study are specific to the sample reviewed and can only be used to extrapolate to a population with similar characteristics (MSME clients with loans originated in FY12 and between INR 500,000 and INR 2.5 million). The multipliers should not be used to extrapolate for non-representative populations, or predict effects in the future as these would not be statistically significant.

(iv) Measurement error: Given the nature of the survey, measurement error is a likely issue in the data. For instance, the results for the key variables used in this analysis were provided by the clients over the phone to their respective loan officers and there may be some sensitivity when reporting results such as their income. As the extrapolation was done using a conservative 95% confidence interval for the population of MSME with loan size at origination in 2012 between INR 500,000 and INR 2.5 million, the growth of jobs and financial performance of the extrapolations are underestimates as they were done for 900 SMEs, while Au's portfolio comprises of approximately 20,000 MSME clients. Furthermore, the study did not take into consideration the growth in surveyed firms' value chains (suppliers or distributors) – which could lead us to underestimate total job growth.

(v) Small Sample Bias: Analysis of the effects of CV loans is based on a small sample of 20 clients, while the CV portfolio is much larger. As a result, these conclusions may not be representative of the entire portfolio and should not be used to extrapolate to the larger population from which the sample was drawn.

Au MSME Sample Description

As described earlier, IFC's team reviewed a sample of 108 loan files from Au's MSME portfolio. As seen in Figure 2a, of the 108 files, the biggest sector represented was retail, with exactly 50% of the files, followed by services with 20% of the files, manufacturing with 18%, education with 8% and agriculture with 4%. The loans taken were primarily for the purpose of working capital (42% of the loan) and investment (41% of loans), with a smaller portion of the loans used for equipment purchase (13%) and refinancing (4%), as shown in Figure 2b.

21 For the purposes of this case study, the term "job creation" means only the direct jobs created by the specific MSMEs in the sample.
22 Conversion factor for FY14 nominal figures to FY14 Real value = Nominal Value/122*100. CPI for FY14 with FY12 as base year is 122.

Figure 2a: Sectorial Distribution of Sample Files

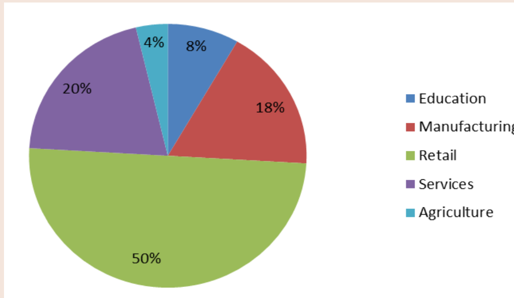
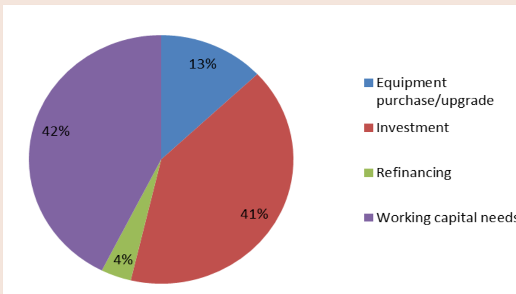


Figure 2b: Purpose of Loans Sampled



Source: Au FINANCIERS Loan File Review

The most typical size firm in the sample is between 2-10 employees (55% of sample firms), while 26% of firms are 1 employee firms and 19% have more than 10 employees. The firm sizes served by Au, as represented in the sample, are typically defined as micro or small enterprises, those that typically have difficulty obtaining access to financing. The World Bank Enterprise Survey for India showed significant differences in the usage of bank loans between small enterprises (between 5-20 employees), with 36.1% of such firms using banks to finance investments, as compared with 54.4% for medium firms (20-99 employees) and 63.2 % for large firms (100 employees and above). The differences in the small firms' access to finance increases when considering working capital: only 21.3% of small firms use banks to finance working capital, as compared with 67.1% of medium firms and 81.7% of large firms.

In terms of firm age, the majority of firms in the MSME sample are mature firms, which have existed for over 10 years (56% of the sample). The rest of the sample firms were divided equally between firms with 5-10 years in existence, and new firms with 5 years and under (both 22% of the sample).

Approximately 60% of respondents had not previously received a loan. This statistic strongly illustrates the important outreach to underserved populations that Au is able to achieve. Despite this impressive outreach, NPL (over 90 days past due) statistics for the

Client with multiple loans: CV, MSME and housing loan.

The client, Mr. Nayak, runs a tour and travel business named "Akshay Tours". He obtained his first CV loan from Au in 2010, and now owns 5 CVs. Before Mr. Nayak began his business, he worked in a hospital, earning INR 15,000-20,000 a month. Now, income from his car fleet is around INR 100,000-150,000 a month, representing a multiple of 5-10 times his previous income. He was also able to buy a house with a housing finance loan from Au, whereas before he was renting a house at a rate of INR 7,000 a month. In addition to these improvements to his income and standard of living, the business also employs Mr. Nayak's son, and 4 other drivers. Furthermore, Mr. Nayak now files taxes for himself and for his business, thus expanding the tax base in the country.

The client explained that he worked with Au FINANCIERS because they did not require paperwork from him that would have been difficult or impossible to obtain, but only needed him to present a guarantor in order to receive financing. He thus obtained in total 5 CV loans from Au, of which 3 are currently paid off in full and 2 are still outstanding. He subsequently obtained an MSME loan to further set up and expand his business, and a housing finance loan as well to purchase a house. The house served as the collateral for both these loans. The client is now able to obtain financing also from other banks because of the documentation and credit history he developed with Au.

sample were quite low, at 1.46% (this is in fact slightly higher than the NPL figure for the overall MSME portfolio, currently at 1.28%). Au relies on property as collateral for MSME loans, and in the sample 63% of the borrowers had pledged their home as collateral for the loan, while 32% used commercial property as collateral. In several cases the property used as collateral was of dual residential and commercial uses.

The average loan size at origination in the sample was INR 725,047 while the average value of collateral used was INR 2,657,605. On average, MSME clients in the sample have 37% of collateral coverage. Furthermore, Au's credit policy does not allow extending a loan in excess of 50% of the value of the collateral offered. On average, education loans in the sample were the largest, with an average size at origination of INR 833,333, while agriculture loans were the smallest, with an average size at origination of INR 500,000.

Changes in key variables from FY12 to FY14

Jobs

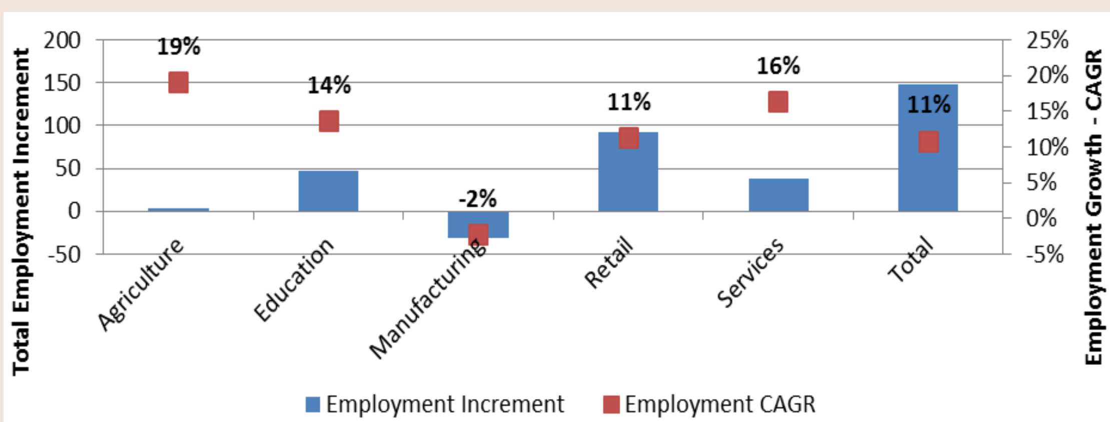
Overall, the Au beneficiaries sampled for the study have shown strong employment growth during the time covered by the study. On average, firms in the sample increased employment by an increment of two workers during the study period. Employment in the overall sample grew from 655 to 803 employees, representing an 11% CAGR in jobs. This compares favorably with the overall growth rate in the Indian economy of 10%[23] during the same time period, and is more notable in LIS where Au primarily operates.

Within the sample different results were observed for different economic sectors, as shown in Figure 3. While most sectors showed impressive growth, ranging from 11% CAGR for retail to 19% for agriculture (albeit with a small sample size), manufacturing firms financed showed a small decrease of 2% in employment. This is consistent with the other variables studied, indicating that manufacturing firms were harder hit than others due to the macro economic conditions during this time period. Most of the growth in jobs in the sampled firms during the study period came from the retail sector, which also accounted for over half of the observations in the sample. Thus, employment in the retail sector observations grew by 92 jobs, out of the total growth of 148 in the sample. The services and education sectors also showed strong total employment increments, with 38 and 47 incremental jobs, respectively.

Examining the sample by looking carefully at how loans were used reveals that most loans resulted in strong and positive employment growth, ranging from 11% for investment purpose to 13% for working capital and equipment purchase/upgrade loans. Only 4 loans in the sample were taken for the purpose of refinancing, and they were associated with job losses of 17%.

Firms of different ages exhibited different patterns of employment growth. While new firms (0-5 years) grew strongly at a CAGR of 20%, and older firms (over 10 years) also grew at a rate of 12%, mid-age firms (5-10 years) lost jobs at a rate of 7% annually. Overall the contribution of older firms to the incremental growth of jobs in the sample was the highest, with 69 jobs gained.

Figure 3: Employment Increment and Growth by Sector



Source: Au Loan Files, Loan Officer Review and Authors' Computation

23 NSSO 66th round report Avg. Employment CAGR for 2004-5 to 2009-10 is 10%.

MSME School Loan

The client, Mr. Mishra, runs a school in Jaipur. The school, which was started in 1994, goes from Kindergarten to 12th grade, and currently has about 1,200 students. The school employs 60 employees in total including teachers and other staff. The client obtained an MSME loan for INR 1.5 million from Au for construction purposes - at the time of client visit he was in the process of adding 2 additional floors to the school, with an area of 4,500 square feet. These additional floors were going to enable to school to add 300-400 additional students, as well as lab rooms and a library. The plan was to add approximately another 10 teachers as well, thus not only expanding educational opportunities but also employment opportunities.

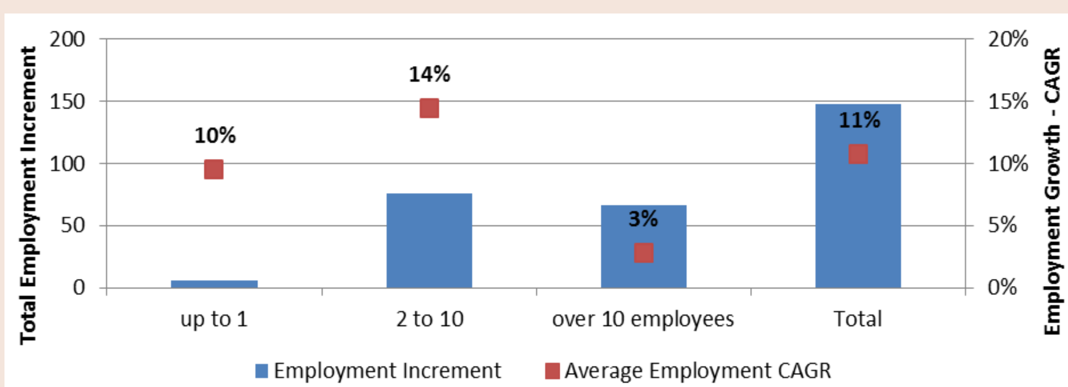
Mr. Mishra currently earns between INR 3-5 million annually. He expects the income to grow by 20-25% once the construction and school expansion is completed. At the time of visit the school had applied for an additional loan from Au in order to complete the construction. Mr. Mishra mentioned that he had previously received a loan from another source, but that he chose to work with Au due to the ease of processing his loan.

The size of the firms studied also showed important differences in employment growth as can be observed in Figure 4. Whereas firms with 2-10 employees showed an average CAGR of 14%, those with more than 10 employees only showed a growth rate of 3% in employment. This may indicate that these firms have an unmet need for further financing, or that other constraints may be hampering these firms from growing further. However in absolute terms the contribution of the larger firms (above 10 employees) to the growth increment in the sample was significant, with 66 incremental jobs added, slightly less than the 76 jobs added by firms with 2-10 employees. 1 employee firms showed a close to average employment CAGR of 10%.

Comparing loan sizes at origination with the number of incremental jobs obtained in the sample allows us to estimate the size of loan required to create a job. For the Au sample, one job was created for every INR 460,000. Applying this rate to the overall outstanding MSME portfolio as of March 2012, at INR 1.92 billion equivalent, suggests that over 4,190 jobs may be supported through this part of Au's portfolio alone. It is important to note however that since this portfolio contains loans to medium sized enterprises as well as loans to micro enterprises, this calculation could suffer from both under and over estimation effects, which we cannot analyze with existing data.

Also, a deeper analysis was conducted for a slice of Au's MSME portfolio consisting of 857 loans that were generated in 2012 and were above INR 500,000 at origination. Using the sample drawn from these 857 observations, we have used a 95% confidence interval to extrapolate the incremental employment effects for the whole relevant section. The results are at a range

Figure 4: Employment Increment and Growth by Firm Size



Source: Au Loan Files, Loan Officer Review and Authors' Computation

MSME loan- Equipment Finance

The borrower, Mr. Sharma, works for a promoter who manufactures bearings for cars in Jaipur. The facility visited is owned by the promoter, who also supplies the machine operators with the raw materials for production, and then pays employees based on their production. In the facility there were 4 machines overall, one of which was purchased by the borrower using the loan proceeds from Au (cost of machine: INR 1.5 million with a loan amount of INR 1.25 million). Besides working in the facility himself, Mr. Sharma also employs a machine operator. Further, the facility as a whole employs (at least) two women employees to conduct quality control and pack the bearings. The borrower owns a house, which he used as collateral to receive the equipment loan from Au.

Before purchasing the machine, Mr. Sharma used manual processes to produce the bearings. According to the borrower, his production increased tenfold since he started working with the purchased machine. The quality of the product has also increased significantly, and he is now able to obtain from the promoter a price of INR 3 per piece, compared with a price of INR 0.1 previously. Due to the increase in productivity and quality (and despite an increase in electricity consumption), the borrower's net income has increased ten times. Since receiving the loan from Au, Mr. Sharma was also able to purchase two additional machines with loans from state banks. These subsidized loans were available to him now because of the documentation built up through his borrowing from Au, representing another tangible benefit to his income and livelihood.

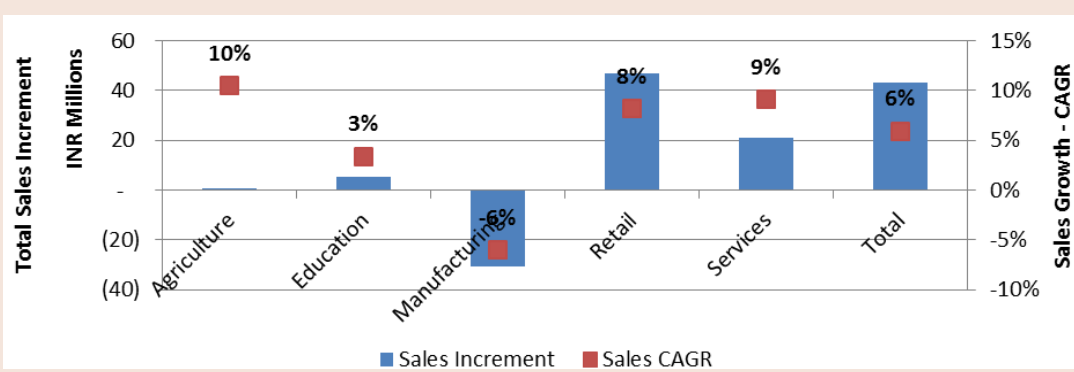
of 268 to 2,460 incremental jobs added for the 857 observations, at the 95% confidence interval, again highlighting the relationship with employment in the regions where Au operates.

Sales

Overall, sales for the beneficiaries in the sample grew by an average CAGR of 6% over the period studied[24]. For beneficiaries for whom observations were available in 2012 and 2014, the average sales increment was approximately INR 468,000.

The sampled firms showed an overall growth in sales of approximately INR 43 million. Again, enterprises in different sectors showed different levels of growth in sales, as shown in Figure 5. While retail and services enterprises grew sales at a rate of 8% and 9%, respectively, education enterprises grew by a rate of 3%, and manufacturing firms suffered from a decline of 6% in sales, again indicating difficulties they have encountered in the past couple of years. A small sample of agricultural enterprises saw sales increase by a CAGR of 10%[24]. In absolute terms, the majority of the increase in sales came from retail and services firms, with roughly INR 47 million and INR 21 million, respectively. However, these gains were partially offset by the decline in sales of manufacturing firms in the sample, a reduction of nearly INR 31 million.

Figure 5: Sales Increment and Growth by Sector



Source: Au Loan Files, Loan Officer Review and Authors' Computation

24 CAGR adjusted for inflation.

Loans taken for different purposes yielded varied results in terms of sales growth. While working capital loans had very strong impact on sales growth, at 12% CAGR on average for firms in the sample, loans for investment saw 1% average sales CAGR[25], and equipment purchase/upgrade loans had a CAGR of 3%[25] on average. Refinancing loans had a negative CAGR of -7%. However, only 4 loans in the sample were used for this purpose, thus making generalization not possible. In absolute terms, working capital loans had an increment in sales of nearly INR 62 million, which was offset by negative increments in sales for investment and refinancing loans, with declines of approximately INR 9 and 12 million, respectively. Thus working capital loans were associated with average sales increases of about INR 1.5 million.

New firms showed the strongest sales growth of the firms sampled, with a CAGR of 11%[25]. These firms also had the largest share of the growth in sales, with INR 32.5 million of the total growth. This compares with 7% CAGR[24] for firms over 10 years in existence, which had an increment of INR 23 million in sales overall. On the other hand, firms of 5-10 years in age exhibited sales declines at an average CAGR of -5%[25].

Firms with 1 employee and firms with 2-10 employees showed an average CAGR of 9%[25] in sales. Firms with 2 -10 employees and firms with 1 employee had an absolute sales growth of about INR 58.5 million and INR 10.5 million respectively. However, firms with more than 10 employees saw a reduction in sales at a CAGR of 5%[25]. As mentioned with regards to jobs, this again reflects the unique challenges to growth faced by enterprises of this size.

Income

MSME beneficiaries in the sample saw an increase in their incomes during the study period at a CAGR of 5%[25], slightly below the rate at which sales increased. As observed for sales, there were significant differences between the performances of different sectors in terms of income growth. Retail, Services and Agriculture performed strongly, with CAGRs of 7%, 7% and 8%[25], respectively, while Education beneficiaries saw a CAGR of 1%[25], and manufacturing firms saw a negative CAGR of -7%[25] during this period. In absolute terms, retail firms in the sample saw an overall increase in their income amounting to INR 3.7 million, while service firms saw an increase of INR 1.9 million. At the same time manufacturing firms saw a decline in income of INR 7.2 million, thus offsetting the gains for the sample as a whole.

Similar to the observations regarding sales, loans taken for different purposes resulted in varied growth rates in income. Working capital loans had the best results, with an income CAGR of 7%[25], while equipment purchase/upgrade loans had a CAGR of 5%[25], and investment saw a 3% CAGR[25] in income. Again, refinancing loans had a negative CAGR of 6%[25], but with a very small sample size.

New firms (0-5 years in age) had the largest increases in income in the sample, with a CAGR of 9%[25]. Firms over 10 years in age also saw strong increases in income, with an average CAGR of 6%[25]. However, firms in between these two categories, with 5-10 years history, did not perform as well and saw real decreases in income of 8% year on year.

The effects of firm size on income were clear in the sample - the biggest increase was enjoyed by 1 employee firms, at an average CAGR of 9%[25]. This was followed by enterprises with 2-10 employees, which saw income rise by a CAGR of 5%[25]. Firms in the larger category of above 10 employees saw income decrease at a CAGR of -3%[25].

Assets

With the loans taken from Au, and the additional income generated, beneficiaries were able to accumulate additional productive assets, such as commercial property, vehicles and equipment/machinery. The growth in asset value for MSMEs sampled was an impressive 10% average CAGR[25], or INR 113.5 million for the 87 beneficiaries for which data were available for both years. On average, beneficiaries expanded their assets by over INR 1.3 million.

Retail enterprises account for the largest absolute share of the growth in assets in the sample, with an increase of over INR 50 million. This is followed by education enterprises with an increase in assets of over INR 28 million, and service firms with nearly INR 27 million increase. Manufacturing and agriculture enterprises saw smaller increases. In percentage terms, education firms had the highest CAGR in assets, with 23%[25], however with a relatively small sample size. Retail followed with a CAGR of 12%[25] and services with 9% CAGR[25] in the real value of assets. Although manufacturing firms saw an absolute increase in assets, their average CAGR was slightly negative, at -3%[25].

Enterprises that used loans for investment and for working capital experienced an average CAGR in their assets of 12%[25]. In absolute terms, those that

25 CAGR adjusted for inflation.

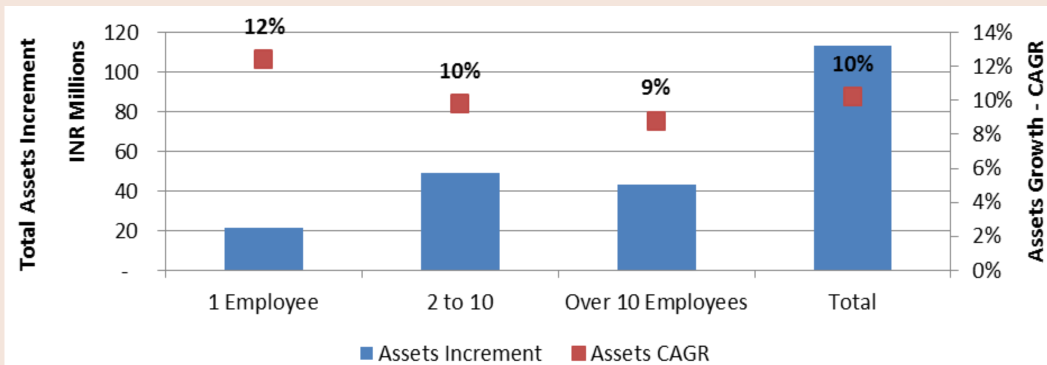
borrowed for investment had an overall increment of nearly INR 60 million in real terms during the study period, while enterprises using the loan for working capital saw assets grow by over INR 40 million. Loans taken to upgrade/purchase equipment were surprisingly less beneficial to asset growth, with a 2% average CAGR[26] and an INR 15.5 million overall increment. Finally a slightly negative CAGR of -3%[26] in the real value of assets was observed in the small sample of firms which used loans for refinancing.

MSMEs of all ages saw increases in assets during the study period, with older firms seeing slightly higher increases. Assets of firms over 10 years in age increased by an average CAGR of 11%[26], while those between 5-10 years in age increased by 10%, and 1 employee enterprises assets grew by 8%. The largest share of the increase in assets came from mature enterprises, with real growth of nearly INR 49 million in assets. This was followed by 1 employee firms, with an absolute increase of INR 45.5 million for the firms in the sample.

As shown in Figure 6, enterprises of all size categories within the sample benefitted from increases in their assets during the period studied. Enterprises with 2-10 employees contributed the largest share of the increment in assets, with nearly INR 49 million. The average CAGR[26] in assets for these enterprises was 10% during this period. Firms with over 10 employees showed increases of 9% in their assets year on year, while 1- employee firms had the best average CAGR in the sample, at 12%[26].

We have also estimated the aggregate effect on assets for the 857 observations from which our sample was drawn. As mentioned earlier, this universe includes loans from Au's MSME portfolio generated in 2012 excluding all loans below INR 500,000 at origination. We have used a 95% confidence interval to extrapolate the incremental asset growth effects for the relevant section of 857 observations. The results show growth in assets for these firms within a range of INR 469 million to INR 1,769 million.

Figure 6: Assets Increment and Growth by Firm Size



Source: Au Loan Files, Loan Officer Review and Authors' Computation

MSME Sample - Overall Observations

Overall, Retail and Services enterprises in the sample performed the best consistently across different measures, as can be seen in Table 1 below. While Education and Agriculture enterprises also performed well across most measures, both sectors had small sample sizes (less than 10) and therefore the analysis of these sectors in isolation is not as significant. Manufacturing enterprises showed the worst performance in the sample across measures. However, this performance was influenced by negative outliers, and an analysis of trimmed means for the sample showed improved results across all measures.

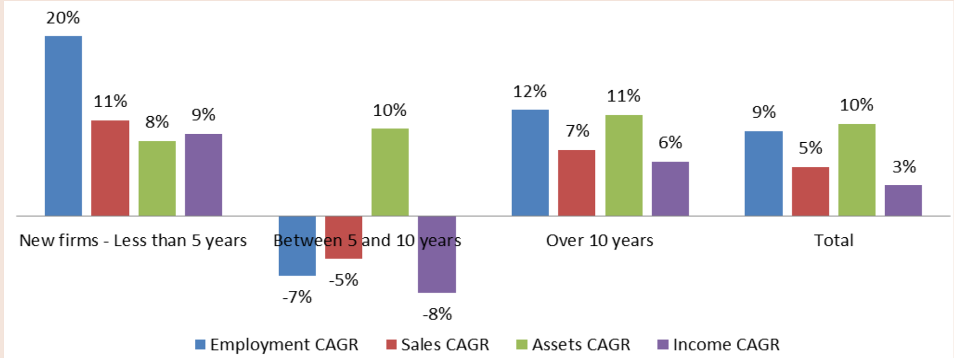
Table 1: Sectorial Growth in All 4 Dimensions

Sector	Employment CAGR	Sales CAGR[26]	Assets CAGR[26]	Income CAGR[26]
Agriculture	19%	10%	2%	8%
Education	14%	3%	23%	1%
Manufacturing	-2%	-6%	-3%	-7%
Retail	11%	8%	12%	7%
Services	16%	9%	9%	7%
Total	**11%**	**6%**	**10%**	**5%**

Source: Au Loan Files, Loan Officer Review and Authors' Computation

26 CAGR adjusted for inflation.

Figure 7: Firm Age Growth in All 4 Dimensions



Source: Au Loan Files, Loan Officer Review and Authors' Computation

Loans taken for the purpose of working capital performed the best across the different measures observed, with growth in employment, sales and assets at 13%, 12% and 12% respectively, and growth in income also above the sample average, reaching 7%. This could suggest that MSME beneficiaries of Au are credit constrained and even small amounts of working capital (which is usually smaller in size then investment capital) can result in significant development results.

As illustrated above in Figure 7, new firms performed best in the sample, outpacing others on 3 out of 4 measures (except asset growth). Firms between 5-10 years in age had negative performance on most variables, however these were influenced by outliers, and median values for all variables were higher and positive (except for employment, with 0% median growth). Older firms showed positive performance for all growth measures.

Firms with 1 employee showed the most consistent growth in the sample studied, with positive CAGRs between 9-12%[27] for all measures. Other firms performed positively on most indicators, except for income for the middle category firms, and sales for the larger firms above 10 employees.

As noted earlier, Au FINANCIERS is able to successfully reach unserved and underserved populations, such as first time borrowers and borrowers in LIS. First time borrowers performed well on all measured growth metrics, including employment, sales, income and assets. However their performance was on average lower than that of non-first time borrowers (except in the asset growth variable). For example, while employment growth was 9% for first time borrowers, existing borrowers saw a 13% CAGR in employment.

Borrowers in LIS (representing about 69% of the sample) performed significantly better than those in non-LIS, suggesting that despite recent expansion, Au has had the most impact so far in LIS. For example, growth in employment was slightly negative in non-LIS, while in LIS it stood at a 16% CAGR[27]. Assets saw real growth of 13% in LIS,[27] while growing at a rate of 4%[27] in other states.

Jobs and sales are positively impacted by access to financial services

Employing simple linear regressions for the MSME sample, we estimated the direction and magnitude of the association between access to financial services and changes in jobs and change in sales. The dependent variable, change in jobs or sales was modelled as follows:

$\Delta Y\ FY_{12\text{-}14} = \alpha + \beta_i \Delta X_i\ FY_{12\text{-}14} + e$

Where :

Y is Jobs or Sales

X_i are the independent variables such as INR Loan amount at origination

α is fixed effect or constant

A positive β implies that change in X_i will result in positive change in Y

Equation 1:

$\Delta Job=(1.5Loan_{FY12}+0.6\Delta Asset+2.1\Delta Income)*10^{(-6)} +e$

P value [0.0845] [0.0008] [0.003]

Equation 1, above, shows the effects of change in assets, income over FY12-14 and loan taken in FY12 on change in jobs. Positive coefficients suggest that increase in loan, assets and income is likely to result in an increase in jobs. Numerically, additional INR 690,000 loan taken in FY12 is expected to result in approximately one new job over the period of the analysis.

27 CAGR adjusted for inflation.

Similarly, INR 1,000,000 of asset growth or income growth over FY12-14[28] is expected to result in approximately 1 and 2 new jobs respectively. Analysis of the p value shows that these results are statistically significant at 90% level of confidence[39] for loan and 99% level of confidence[30] for asset and income.

Equation 2:

ΔSales= 0.25Loan$_{FY12}$+ 0.29ΔAsset+ 2.13ΔIncome +e

P value [0.6648] [0.0227] [0.0000]

Similarly, equation 2, above, shows that change in sales is positively associated with loan in FY12, change in asset and change in income. However, based on the analysis of p values, we conclude that the magnitude of effect is statistically significant only for change in asset and income, i.e. INR 1,000,000 change in asset or income over FY12-14 is expected to result in increase in sales by INR 0.29 million and INR 2.13 million respectively.

The next section analyzes the development effect of Au's transport finance for MSME business, based on a review of a small sample of CV loans.

Au Transport Finance Sample Description

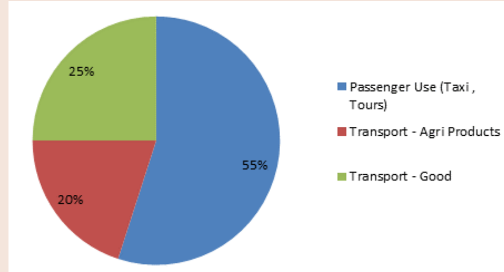
The IFC team reviewed a sample of loan files from Au's Transport finance portfolio which comprises of loans to MSMEs to purchase CVs. The files reviewed were of 20 clients with multiple CV loans and at least 1 CV loan in FY 2012. This analysis was intended to provide an understanding of the profile of CV borrowers with multiple loans, and to assess the effects the multiple loans have had on their income, assets, etc.

Of the 20 clients reviewed, 5 clients had no previous loans from any formal FI (Credit history review of these clients (CIBIL) showed that this was their first ever loan). Of these 5 clients, 2 had no income from this line of business.

As shown in Figure 8, 55% (11 out of 20) of the CV loans sampled were for passenger use - taxis used for intra-city travel or cabs used for inter-city tours. 25% were used for transport of goods, and 20% for the transport of agriculture products.

Additionally, the sample comprised of 4 types of CVs – 8 Heavy Commercial Vehicles (HCV), 2 Light Commercial Vehicles (LCV), 6 Multi Utility Commercial Vehicles (MUV) and 4 Small Commercial Vehicles (SCV). As shown in Table 2, New LCV and HCV were able to secure a higher loan to value (LTV) ratio while MUV and used HCV secured the lowest LTV.

Figure 8: Purpose of CV Loans taken in 2012



Source: Au FINANCIERS Loan File Review

Table 2: Average LTV for New and Used Vehicle Finance by Type of Vehicle in 2012

	New	Used	Total
HCV	84.5 [6]	75.5 [2]	82.2 [8]
LCV	84.7 [2]		84.7 [2]
MUV	72.7 [4]	77.0 [2]	74.1 [6]
SCV	80.8 [2]	80.3 [2]	80.6 [4]
Grand Total	80.6 [14]	77.6 [6]	79.7 [20]

Source: Au FINANCIERS MIS data and Loan File review

Over FY12-15, the 20 clients sampled took CV loans worth INR 59 million, with INR 30 million outstanding at the time of the review (i.e. December FY15).

Changes in Key Variables from FY12 until Latest Loan Taken

Home Ownership

25% of the clients sampled shifted into home ownership during the period studied. In FY12, 5 of the CV clients lived in rented houses, 4 in parental houses while 11 owned their houses. However, over time many of these borrowers purchased residential houses and moved to them. As of FY15, 2 borrowers live in parental houses, 2 live in rented houses while 16 live in their own houses. This shift towards home ownership could be a result of increased income for borrowers which resulted in purchase of houses, i.e. asset building.

Income

On average, 20 customers with multiple CV loans grew their annual real income by 39% CAGR[31] between the loan taken from Au in FY12 and the most

28 This result differs marginally from the extrapolation result (INR 460k loan is expected to result in 1 additional job) as the regression coefficient is a more conservative estimate and is significant at 90% level of significance.
29 P value < 0.1
30 P value < 0.01
31 CAGR adjusted for inflation.

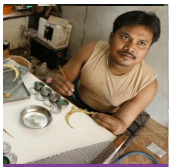
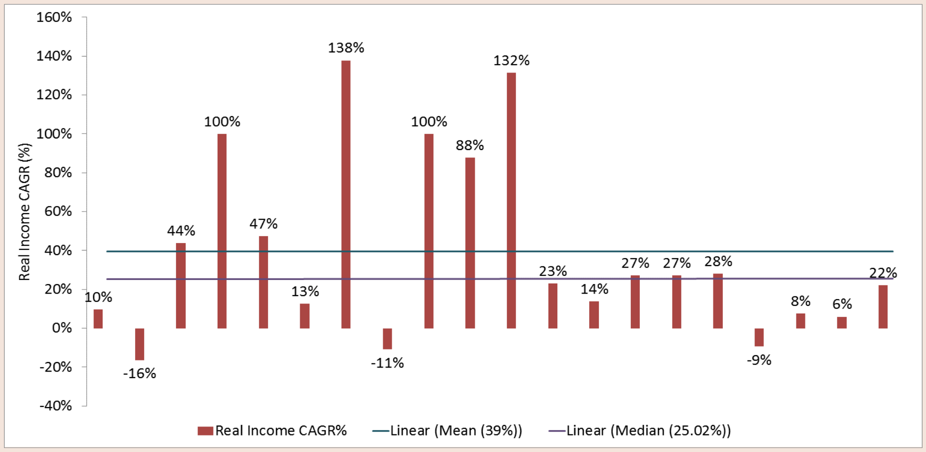


Figure 9: Real Income CAGR (%)



Source: Au FINANCIERS Loan File review

recent loan taken by them (Figure 9 above). This corresponds to a total increase in annual real income from INR 11 million to INR 16.5million . This growth in annual income would either be used to build assets (i.e. purchase houses or new vehicles) or spent on expanding the business.

Growth in Car Fleet

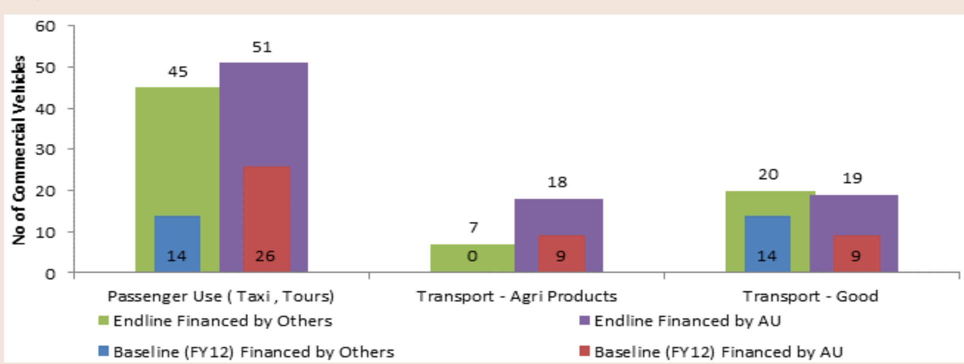
The sampled clients grew their vehicle fleet by 141% CAGR between the loan taken from Au in FY12 and the most recent loan taken by them. In FY12, the 20 clients had 73 outstanding CV loans of which 44 (60%) were taken from Au FINANCIERS in FY12. Over FY12-15, these 20 customers purchased 88 vehicles, of which 44 (50%) were financed by Au FINANCIERS.

As Figure 10 shows, passenger vehicles (taxi or tour cars) were the most popular among the sampled clients. 11 customers had 40 CVs in FY12, with 26 being financed from Au FINANCIERS. By the end, these 11 customers had 96 CVs, with 51 being financed from Au FINANCIERS.

Jobs

Through their financing of the sampled CV portfolio, Au FINANCIERS indirectly supported at least 125 jobs and 63 new jobs were created over the period FY12-FY15. Based on our field interviews and discussions with the client, it is believed that every passenger vehicle employs at least 1 person (i.e. driver) while every transport vehicle employs at least 2 persons (i.e. driver and helper). Also, HCV trucks may employ multiple helpers for loading and unloading goods, i.e. may have more than 2 employees. From Table 3, we conclude that these 20 clients had secured finances in FY12 for 160 CV, with 88 being financed from Au. Thus the 20 clients in the sample supported an estimated total of 224 jobs, of which Au financing indirectly supported 125 jobs. Over FY12-15, the clients took 88 new CV loans, of which 44 were from Au FINANCIERS. This corresponds to at least 120 new jobs being created, with 63 being created as a result of the loans from Au FINANCIERS. This represents a CAGR of 138% in new job creation for CV drivers or helpers. This is significantly higher than the national CAGR of employment in the transport sector (79%). In addition, they grew their real income by 39% over FY12-14.

Figure 10: No of Commercial Vehicles (FY12-15)



Source: Authors computation based on loan file review and Au FINANCIERS MIS date

Note: End line refers to year of most recent loan from Au (it could be FY13-15). The analysis uses number of outstanding CV loans from all lenders (from CIBIL report) as proxy of Total number of CV vehicles

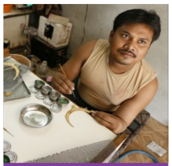


Table 3: Jobs supported and created by finance of commercial vehicles

	Total CVs Financed	Additional CVs Financed	Total no. of Jobs Supported	No. of New Jobs Supported
Passenger Use (Taxi , Tours)	96 [51]	56 [25]	96 [51]	56 [25]
Transport - Agri Products	26 [18]	16 [9]	50 [36]	32 [18]
Transport - Good	39 [19]	16 [10]	78 [38]	32 [20]
Grand Total	**161 [88]**	**88 [44]**	**224 [125]**	**120 [63]**

Source: Authors computation based on loan file review and field interview, figures in parenthesis are Au's contribution

Multiple Commercial Vehicle Loans

Mr. Lal is a long time Au FINANCIERS client. He obtained his first vehicle loan from Au in 1997. Previously, Mr. Lal made a living by washing cars, earning around INR 1,000 a month. Now, he has a fleet of 14 cars used to transport children to schools, and he earns INR 50,000 a month. All of the borrower's cars were purchased with loans from Au, which is his only source of financing. He originally approached Au for funding due to his knowledge of the Relationship Officer. He has since kept a perfect track record of repayment with Au, which has enabled him to expand his assets successfully.

The business developed by Mr. Lal has had many positive implications for his life and those of others. He now employs 14 drivers as well as his brother. Beyond the tremendous increase in his income, he has been able to renovate his house (which he received as inheritance), purchase two plots of land, and is spending most of his income on educating his three teenage children (a girl and two boys), as well as his brother's two children.

Conclusion

The private sector, which provides about 90% of jobs in developing countries, is a key player in meeting the global development challenge of job creation. It is crucial, therefore, to understand the constraints that prevent the private sector from growing and generating jobs. Jobs in MSMEs account for more than half of all formal employment worldwide. In India, these enterprises are also a significant contributor to GDP. Governments and development finance institutions must help build an environment where these obstacles to the success of MSMEs are minimized or removed.

This study assesses the contribution that an IFC partner FI, Au FINANCIERS, made towards financial inclusion, job creation and the financial performance of its MSME beneficiaries in India from FY12 – FY14. In particular, the study tries to understand which MSMEs are obtaining financing, what is this financing being used for, how many jobs are being created or supported, and how have their assets, income, and sales changed over time.

The study concludes that despite challenging macro-economic downturns in 2011-12, clients with MSME and CV loans show positive effects on jobs being supported, sales, assets and income. Data collected for about 100 MSMEs revealed that the overall number of new jobs created in the sample grew at a CAGR of 11% between FY12 and FY14, higher than the national CAGR of 10%. Employment growth has been complemented by high sales and assets growth. Overall sales grew at a CAGR of 6%[32], and overall assets grew at a CAGR of 10%[32]. In addition, the review of loan files for 20 random clients with multiple CV loans, revealed that they have used these to purchase at least 88 new vehicles, of which 50% were financed by Au FINANCIERS. This resulted in 138% CAGR in new jobs being created for drivers or helpers for CVs. This is significantly higher than the national compound growth rate of employment in the transport sector (79%). In addition, the CV clients grew their real income by 39%[32] over FY12-14.

Interviews with Au beneficiaries have confirmed the impact that working with Au FINANCIERS has had on

32 CAGR adjusted for inflation.

their lives. Beneficiaries have seen substantial increase in income and assets. They have been able to increase employment in their growing businesses, as well as invest disposable income into the education of their children. In addition, many borrowers who were previously financially excluded opened bank accounts, and are now able to obtain financing from other FIs due to the documentation and credit history they have developed by borrowing from Au FINANCIERS. The results validate the thinking that MSMEs are vital to support economic growth and create new jobs in developing economies like India. This should encourage other FIs to continue supporting MSMEs through financing and other services.

The findings of this study reinforce the following:

- Financial intermediaries like Au FINANCIERS, which provide access to finance for MSMEs in underserved markets, are expected to have significant financial inclusion and job creation effects and positively affect financial performance of MSMEs;

- In order to promote financial inclusion, growth and job creation, IFC and financial intermediaries like Au should continue to support MSMEs, in particular in the retail and service sectors, which were observed to have consistently the highest developmental effects;

- IFC and financial intermediaries should continue to support small firms and help them become bigger, as small firms have the potential to realize the greatest impact on employment and, as a result, on economic growth;

- IFC and financial intermediaries should continue to support unserved MSME and individuals who do not have access to formal financial services, as these firms greatly benefit from lower cost formal access to financial services and contribute to financial inclusion and job creation. This financial inclusion of the unbanked is likely to have linkage effects to their suppliers and associates who may also be unbanked.

- More research is needed to better understand the effects of access to financial services on financial inclusion, job creation and firm financial performance via different types of financial intermediaries (banks, small banks, NBFCs), different financial products (CV, MSME loans, insurance, etc.) and the use of different evaluative techniques, such as Randomized Control Trials (RCT).